

Unjustice on the Taxation of Income from Construction Service

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Abstract

Income earned from construction services is subject to tax with a specific final Income Tax flat rate applied to gross income. It is different from the general Income Tax rate where net income is a basis of tax calculation. The current legislation of Income Tax on income derived from construction services in Indonesia is Government Regulation Number 51 of the Year 2008 as amended by Government Regulation Number 40 of the Year 2009. This paper intended to do an in-depth analysis of whether the regulation conformed with equity principle as referred to legal theory and taxation theory. This research is legal research using a normative method. The result of research concludes that the current regulation on the taxation of income derived from construction services is not in line with the principle of horizontal equity and vertical equity because tax imposed not based on their ability to pay that reflected in net income.

Keywords: Reconstruction, Construction Services Income Tax, Final Tax, Equity, Regulation,

1. INTRODUCTION

The tax sector has become the primary source of state revenue to finance state expenditure for routine and development costs in recent years in Indonesia. The revenue target of this sector increase every year. Over the past four years, the contribution of tax revenues has reached over 80% of total state revenue. The higher the tax revenue target each year become a challenge for the government mainly for Directorate General of Taxation at the Ministry of Finance to work more optimally so that it needs to take specific policy steps in order to increase tax revenue.

One source of tax revenue that is very potential to explore more profoundly is from the construction services business sector. The rapid growth in the construction services sector has a positive impact on increasing the tax revenues from this sector. As with other business sectors, business entities or individuals engaged in a construction service business should pay Income Tax because the income earned from the construction service business is an object that is subject to income tax.

The current Income Tax provision for income from a construction service business is Government Regulation Number 51 of 2008 concerning Income Tax on Income from Construction Services Businesses as amended by Government Regulation Number 40 of 2009 (after this referred to as GR 51 of 2008 jo GR 40 of 2009). Further provisions concerning the procedures for withholding, payment, reporting and administering Income Tax are regulated in the Regulation of the Minister of Finance Number 187 / PMK.03 / 2008 as amended by Regulation of the Minister of Finance Number 153 / PMK.03 / 2009 (after this abbreviated as PMK 187 / 2008 jo PMK 153/2009).

Income from the construction services business is subject to Income Tax at a specific rate and is final. Because the tax obligation is deemed to complete and final, the income no more subject to general rates provided in Article 17 paragraph (1) Law Number 7 of 1983 concerning Income Tax as amended several times a by Law Number 36 of 2008 (after this referred to as the 2008 Income Tax Law).

The amount of Final Income Tax rates according to the Government Regulation above for income from construction services business is as follows:

- a. 2% (two percent) for Construction Implementation carried out by Service Providers who have small qualifications
- b. 4% (four percent) for Construction Implementation carried out by Service Providers who do not have business qualifications
- c. 3% (three percent) for Construction Implementation carried out by a Service Provider other than the Service Provider as referred to in point a and point b;
- d. 4% (four percent) for Construction Planning or Construction Supervision carried out by Service Providers who have business qualifications; and
- e. 6% (six percent) for Construction Planning or Construction Supervision carried out by Service Providers who do not have business qualifications.¹

The basis for the imposition of Final Income Tax on income from construction services business is gross

¹ See Article 3 of Indonesian Government Regulation (GR) Number 51 of the Year 2008 regarding Income Tax on Income earned from Construction Services as amended by Government Regulation Number 40 of the Year 2009

income. The meaning of gross income is the total amount of payments received by the construction service entrepreneur (contractor) from the user of construction services (project owner) which is the total value of the construction contract excluding Value Added Tax (VAT). Referred to as "gross" income is because this amount reduced by construction costs and other costs incurred to generate the construction services income. Since Final Income Tax calculated from gross income, the imposition of income tax does not depend on the actual amount of profit from a construction project. Even in the case of loss position, construction service businesses are still subject to income tax.

In contrast to Final Income Tax, non-final income tax calculated at the general rate and the basis for the imposition is net income, which is gross income after deducting costs related with generating the income. If a taxpayer gets a loss, the taxpayer is not subject to income tax, and even the loss allowed to compensate with the net income up to 5 (five) consecutive years. Meanwhile, general rates according to Article 17 paragraph (1) of the current Income Tax Law are:

a. Individual resident taxpayers

Table 1. Individual General Income Tax Rate

The Layer of Taxable Income	Rate
Up to Rp. 50 million	5%
Above Rp. 50 million up to Rp. 250 million	15%
Above Rp. 250 million up to Rp. 500 million	25%
Above Rp. 500 million	30%

b. Company resident taxpayers and permanent establishment: rate 25%.

For domestic corporate taxpayers that have a gross income of up to Rp. 50,000,000,000 at a rate reduction of 50% of the general rate Article 17 paragraph (1) point b of 25% above, which is 12.5% of the taxable income from the gross income of up to Rp.4,800,000,000.¹

This paper includes an analysis of the relevant regulations concerning the principle of equity (justice) based on the principles of taxation.

2. METHODOLOGY

The research method used in this paper is normative legal research that focus of the study is legal norms. The research was conducted by studying and analyzing the applicable tax provisions and other current laws that are relevant to the legal issues. The research compares the regulation of Income Tax on construction services business regulated in PP 51 of 2008 jo PP 40 of 2009 with the theory of justice and equity in taxation. The research approach used in this paper is the statute approach, the historical approach, and the conceptual approach.²

3. RESULT AND DISCUSSION

Aristotle distinguishes justice into 2 (two) types, namely distributive justice and corrective justice.³ Distributive justice is identical with justice by proportional equality, while corrective justice is a correction of the wrong⁴. Corrective justice relieves equality. Distributive justice refers to the existence of equality between humans based on the principle of proportionality. Distributive justice theory according to Aristotle based on the principle of proportionality is in line with the concept of taxation where the taxpayers pay taxes by their ability to pay or proportionally according to their ability.

Tax collection must consider justice. Adam Smith in his book *Wealth of Nations*, as quoted by Rochmat Soemitro, put forward 4 (four) principles of taxation that are very well known as "The Four Maxims," namely: equality and equity; certainty, the convenience of payment, and economics of collection.⁵

Concerning justice in tax collection, confirmed with Adam Smith, Richard A. Musgrave, and Peggy B. Musgrave stated the existence of 2 (two) kinds of justice principles, namely the Benefit Principle and Ability to Pay Principle.⁶ The Benefit Principle emphasizes that every taxpayer must pay according to the benefits he enjoys from the government. In this case, it is necessary to know the number of benefits enjoyed by the taxpayer concerned from government activities financed from the tax revenue, so that in practice this principle is difficult to apply in general but is more appropriate for the collection of levies (non-tax) whose benefits are directly enjoyed by the payer. Meanwhile, the ability to pay approach emphasizes that tax imposition on taxpayers

¹ See Article 31 E of the Republic of Indonesia Law Number 7 of 1983 concerning Income Tax as amended several times, the latest by Law Number 36 of 2008 concerning the Fourth Amendment to Law Number 7 of 1983 concerning Income Tax.

² Peter Mahmud Marzuki, *Penelitian Hukum*, Cetakan 12, Edisi Revisi, (Jakarta: Kencana Prenada Media Group, 2016), p. 133

³ Hans Kelsen, *Dasar-dasar Hukum Normatif*, (Bandung: Penerbit Nusa Media, 2008), p.146 -148

⁴ Tanya L Bernard, Yoan N. Simanjuntak dan Markus Y. Hage, *Teori Hukum, Strategi Tertib Manusia Lintas Ruang dan Generasi*, Cetakan IV, Edisi Revisi, Yogyakarta: Genta Publishing, 2013, p. 42-43

⁵ Rochmat Soemitro, *Asas-asas Dan Dasar Perpajakan 1*, Edisi Revisi, Cetakan Keempat, Bandung: PT.Eresco, 1990, p.15

⁶ Musgrave, Richard A & Musgrave, Peggy B, *Public Finance in Theory and Practice*, (New York: McGraw Hill Company, 1989), p. 219

should be on their respective abilities.

In line with the objectives of a legal, the Tax Law which is part of Public Law, namely Administrative Law in Indonesia, is indeed not free from aspects of justice in tax collection. Equity or fairness is an essential principle in considering various tax policy options.¹ The principle of justice must always adhere to both in the making of the provisions of the legislation and in its implementation so that tax collection which is the primary source of the state budget in financing government and development activities conducted in a general and equitable manner.²

3.1. Gross Income as a Base for Imposing Income Tax

As previously described, the basis for the imposition of income tax on income from a construction service business based on GR 51 of 2008 jo GR 40 of 2009 is from the total payment exclude Value Added Tax. It is valid if the Withholding Income Tax deducted by the user of construction services or is self-paid by the construction service provider. The amount of the payment is part of the overall value of the construction service contract. In other words, the basis for imposing the income tax on income from construction services is gross income. It is not following the ability to pay principle which reflected in net income that is the amount of gross income after deducted by all costs incurred in order to derive the income. Costs that can be deducted from gross income to determine the amount of taxable income regulated in Article 6 paragraph (1) of the 2008 Income Tax Law, which is the cost of obtaining, collecting, and maintaining income, including among others costs directly or indirectly related to business activities, such as: the cost of purchasing materials, wages, marketing and administrative expenses. However, by applying gross income as a basis for the imposition of Final Income Tax, GR 51 of 2008 jo GR 40 of 2009 does not allow taxpayers who earn income from construction services business to claim the costs incurred as a deduction to the income. The logical consequence is that regardless of whether the net income is positive (profit) or negative (loss) the taxpayer is required to pay Income Tax. Thus the amount of net income is irrelevant to the amount of tax burden because the tax calculated on gross income, even in the case of a tax, it must still pay Income Tax.

The situation where of a taxpayer suffering of loss but required to pay Income Tax, it is indeed not fair. Net income that shows a negative number or loss is not in accordance with the definition of income as stated in Article 4 paragraph (1) of the 2008 Income Tax Law, which is each of additional economic ability received or derived by a taxpayer that can be used for consumption or to increase the taxpayer's wealth by name and in any form. The object of income tax under the 2008 Income Tax Law is income which is an increase in economic capacity. Taxpayers who in a loss position do not meet the criteria of obtaining additional economic capacity, but precisely the opposite is the case so that they should not be obliged to pay income tax. It is a deviation from the principle of Horizontal Equity which requires net income as the basis for taxation, not gross income.

Furthermore, with the gross income as the basis for imposing the income tax on income from the construction service business, it is also not following the principle of Vertical Equity, which requires higher tax payments for a person or entity along with the higher income earned. What is meant by income, in this case, is net income. Construction service companies that can earn high net income will benefit from tax savings compared to those who get lesser net income, especially compared to companies that get negative net income (loss).

3.2. Discrimination of Types / Sources of Income

The tax treatment of income from construction services business which is final and with a specific rate out of the prevailing general rate as stipulated in Article 17 paragraph (1) of the 2008 Income Tax Law has directly distinguished types or sources of income for taxation purposes. It is not in line with the original concept of the Income Tax system in Indonesia. The system adheres to the global tax system in which all income is by name and in any form, whether received or derived from Indonesia or from outside Indonesia which in all is additional economic capability is combined into a single global entity as an income tax object to tax by a general rate that applies to all taxpayers.³ Global taxation is considered to be the fairest tax system for income because it meets the concepts of Horizontal Equity and Vertical Equity.⁴ Elucidation of Article 4 paragraph (1) of the 2008 Income Tax Law confirms that the notion of income, in this case, does not take into account the existence of income from specific sources, but in the presence of additional economic capacity which is the best measure of the ability to pay taxes.⁵ In other words, the imposition of income tax should not distinguish the source and type of income derived by the taxpayer.

¹ Haula Rosdiana dan Rasin Tarigan, *Perpajakan, Teori dan Aplikasi*, (Jakarta: PT.RajaGrafindo Persada, 2005), p. 120

² R.Mansury, *Panduan Konsep Utama Pajak Penghasilan Indonesia, Jilid 1, Uraian Umum dan Tentang Siapa-siapa Yang Dituju Untuk Dikenakan Pajak* (Jakarta: PT Bina Rena Pariwisata, 1994), p. 25

³ Mansury R, *Pajak Penghasilan Lanjutan*, (Jakarta: IND-HILL-CO, 1996), p.82

⁴ *Ibid*

⁵ See elucidation of Article 4 section (1) of the 2008 Income Tax Law

Furthermore, the elucidation of Article 4 paragraph (1) of the 2008 Income Tax Law states that the 2008 Income Tax Law adheres to a broad definition of income in which all types of income received or derived in a tax year are combined into one basis of Income Tax. So the income is not distinguished by taxation because all of them will be multiplied by the general rate that applies equally to all types of income. It is in line with the concept of the comprehensive tax base as follows:

“A dollar gained through the sale of share, bond or piece of real property bestows the same economic power as a dollar gained through employment or operating a business. The equity principles we hold dictate that both should be taxed in the same way. To tax the gain on the disposal of property more lightly than other kinds of gains or not all would be grossly unfair.”¹

From the above quote, indeed income derived from the sale of shares, bonds or real estate principally has the same economic power as income derived from work or business activities. The principle of justice says that whatever type of income must be subject to tax in the same way. Taxing income from real estate sales with less than taxation on other types of income such as income from construction service is unfair.

The taxation system that distinguishes sources and types of income for taxation purposes is a form of discrimination and deviates from the principle of equality in universal law and tax law in particular.

3.3. Discrimination of Income Tax Rates

Specific rate arrangements for income from construction services that are different from general rates are deviations from the principle of equality proposed by Adam Smith or the principle of non-discrimination in law. The following Table 2 describes the difference in the calculation of Income Tax for companies resident taxpayers based on both Non-final General rate (net income basis) and Final Income Tax rate (gross income basis).

Table 2. Comparison of Income Tax Calculation by General Income Tax Rate and Final Income Tax Rate

General Income Tax Rate (net income basis)			Final Income Tax Rate (gross income basis)		
Contract Revenue	Rp. 60.000.000.000	a	Contract Revenue	Rp. 60.000.000.000	a
Construction cost	(Rp.48.000.000.000)	b	Construction cost	(Rp.48.000.000.000)	b
Gross profit	Rp. 12.000.000.000	c	Gross profit	Rp. 12.000.000.000	c
Op. Expenses	(Rp. 5.400.000.000)	d	Op. Expenses	(Rp. 5.400.000.000)	d
Operating Income	Rp. 6.800.000.000	e	Operating Income	Rp. 6.800.000.000	e
Other Income (expenses)	(Rp. 300.000.000)	f	Other Income (expenses)	(Rp. 300.000.000)	f
Income Before Tax	Rp. 6.500.000.000	g	Income Before Tax	Rp. 6.500.000.000	g
Income Tax	Rp. 1.625.000.000		Beban PPh	Rp. 1.800.000.000	
General rate	(25% x g) 25% x 6,5 billion		Final rate	(3% x a) 3% x 60 billion	

Notes:

Assuming that no fiscal adjustment so Income Before Tax is the same amount with Taxable Income

From the illustrations presented in Table 2 above, what happens is discrimination in rate. When compared based on effective rates, that is the amount of tax payable divided by the amount of taxable income, and it is clear that there is a difference with the following calculation:

$$\text{Effective rate with the application of the general rate: } \frac{1.625.000.000}{6.500.000.000} = 25\%$$

$$\text{Effective rate with the application of the final rate: } \frac{1.800.000.000}{6.500.000.000} = 27.69\%$$

In this illustration, the percentage of Taxable Income on Gross Income is 10.83% which is calculated from:

$$\frac{6.500.000.000}{60.000.000.000} = 10.83\%$$

In this case, the construction service company in the illustration obtain Profit Before Income Tax of 10.83% of Gross Income. In the condition of achieving Profit Before Income Tax or Taxable Income of Rp. 6,500,000,000 or 10.83% of Gross Income, the construction service company in the illustration will bear the burden of effective income tax greater (27.69%) compared to when compared to the general rate (25%).

Furthermore, assuming that the company can obtain a taxable income of 15%, that is from gross income of

¹ John G.Head, Lars Osberg, Leslie Green, A. Marguerite Cassin dan Leo Panitch, *Fairness in Taxation, Exploring the Principles* Edited by Allan M.Maslove (Toronto: University of Toronto Press, 2014), p. 94

Rp. 9,000,000,000 (15% x Rp. 60 billion) then the Income Tax payable at a general rate of 25% under Article 17 (1) of the 2008 Income Tax Law is a total of Rp. 2,250,000,000. Meanwhile, with the application of the 3% Final Income Tax rate, the income tax expense is not affected by the amount of profit or taxable income earned so that the final income tax remains a total of Rp. 1,800,000,000 (3% of Rp. 60 billion). Comparison of effective rate between the imposition of general rate and Final Income Tax rates as follows:

$$\begin{aligned} \text{Effective rate with the application of a general rate: } & \frac{2,250,000,000}{9,000,000,000} = 25\% \\ \text{Effective rate with the application of the final rate: } & \frac{1,800,000,000}{9,000,000,000} = 20\% \end{aligned}$$

From the comparison of the effective rates above, the conclusion in these conditions that construction service companies will bear the burden of effective income tax rates is smaller (20%) when compared to if the general rate is applied (25%). This condition does not reflect the principle of Vertical Equity which states that the tax burden should be higher as income increases. What happens as in the last illustration is the opposite, namely the higher the taxable income, the smaller the income tax payable or borne.

From the above description, the application of specific rate and final on the income from the construction services business with the basis of Article 4 (2) of Income Tax Law different from the general rate of Income Tax Article 17 (1), the service company construction can benefit or be disadvantaged compared to general rates depending on how much the company can make a profit.

To see at what point a construction services company with medium business qualifications or big business qualifications with Final Income Tax rates 3% do not benefit or are not disadvantaged compared to the general rate of Article 17 paragraph (1) 2008 Income Tax Law of 25%, then conclusions can be drawn from the following simple equation:

$$\begin{array}{l} \text{At Final Rate} \qquad \qquad \qquad \text{At General Rate} \\ 3\% \times \text{Gross Revenue} = 25\% \times 12\% \times \text{Gross Revenue} \\ \text{(a)} \qquad \qquad \qquad \qquad \text{(b)} \quad \text{(c)} \end{array}$$

Notes:

- (a) Final Income Tax rate according to GR 51/2008 jo GR 40 /2009 for construction services companies with Medium and Large Grade
- (b) General Rate of Art.17 (1) Income Tax Law
- (c) Percentage of Taxable Income to Gross Income

From the above equation, it concludes that if a taxpayer of a construction service company with medium or large qualification receives a percentage of taxable income below 12% then the construction company will pay more income tax with a Final Income Tax of 3% of gross income compared to the burden Income Tax with a general rate of 25% of taxable income.

For more details, the equation in the form of numbers presented in the following Table 3:

Table 3. Comparison of Income Tax Calculation by General Income Tax Rate and Final Income Tax Rate

General Income Tax Rate		Final Income Tax Rate	
Contract Revenue	Rp. 75.000.000.000	Contract Revenue	Rp. 75.000.000.000
Construction Cost	(Rp. 60.000.000.000)		
Gross Profit	Rp. 15.000.000.000		
Operating Expenses	(Rp. 6.750.000.000)		
Operating Income	Rp. 8.250.000.000		
Other Income (expenses)	(Rp. 375.000.000)		
Income Before Tax	Rp. 7.875.000.000		
Fiscal Adjustment -net	Rp. 1.125.000.000		
Taxable Income	Rp. 9.000.000.000		
	(12% x Rp. 75 billion)		
Income Tax	Rp. 2.250.000.000	Income Tax	Rp. 2.250.000.000
Rate Article 17 par 1 point b	(25% x Rp. 9 billion)	Final rate	(3% x Rp. 75 Milyar)

Source: processed by the author

If, for example, the construction company in the illustration above only receives a taxable income of 5% of the gross income of Rp. 3.75 billion (5% x Rp. 75 billion), the income tax expense at the general rate is 25% x Rp. 3.75 billion = Rp. 937,500,000. However, because it is subject to Final Income Tax at a rate of 3% of Gross Income, the Income Tax expense will be higher, that is 3% x Rp. 75 billion = Rp. 2.25 billion. Thus there is a difference over the income tax expense due in the amount of Rp. 1,312,500,000 that is Rp. 2,250,000,000 minus

Rp. 937,500,000.

Conversely, if the construction service company can obtain a taxable income of 15% of gross income that is Rp. 11.25 billion (15% x Rp. 75 billion), the income tax expense at the general rate is 25% x Rp. 11.25 billion = Rp. 2,812,500,000. However, because it is subject to Final Income Tax at a rate of 3% of Gross Income, the income tax will be less, that is 3% x Rp. 75 billion = Rp. 2,250,000,000. Thus there is a difference over the income tax saved by Rp.562,500,000, namely Rp. 2,812,500,000,000 minus Rp.2,250,000,000.

From the illustration above it can be concluded that there is discrimination in taxation among the type of income derived. Income from businesses that taxed by the provisions of the general rate Article 17 paragraph (1) of the 2008 Income Tax Law is different with the taxation of income obtained from a construction service company that is subject to Final Income Tax. It is apparently in injustice because the same taxable income does not subject to the same burden of Income Tax. It deviates from the principle of Horizontal Equity. Even companies that generate higher profits pay a smaller effective tax rate so that they do not fulfill the principle of Vertical Equity.

In addition to the rate discrimination between income from a construction service business and income from other sources as described above, rate discrimination also occurs among construction service companies. The differentiation of Final Income Tax rates in GR 51 of 2008 jo GR 40 of 2009 that is between construction service companies that have business qualifications and those who do not have business qualifications is the fact. For Construction Implementation Services, the rate is 2% of the total payment for construction services for companies with small qualifications and 3% rate for companies with medium and large qualifications, while if they do not have business qualifications, the rate is 4%. Furthermore, for Planning and Construction Supervision Services, the rate is 4% of the total payment for those who have business qualifications and 6% for those who do not have business qualifications.

According to the researcher, because the object of Income Tax is income itself, that is every additional economic ability received or obtained by a person or entity taxpayer as referred to in Article 4 paragraph (1) of the 2008 Income Tax Law, then the difference in rates is based on whether the contractor has a qualification or not is irrelevant. Besides, the difference based on the qualification level of Construction service businesses issued by the authorized body (LPJK) should not be the determinant. The definition of Income in Article 4 paragraph (1) of the 2008 Income Tax Law does not distinguish how the income earned. By name and in any form, the increase in economic ability that can be consumed or increase the taxpayer's wealth is income that is subject to income tax. Therefore, rate differences, especially from the same source, namely income from a construction service business is a form of rate discrimination that results in injustice among taxpayers who earn income from the construction service business. Rate differentiation should be on the differences in the amount of income or additional economic capacity among taxpayers, that is with a progressive layered rate in order to enforce Vertical Equity where the higher the income, the higher the tax to pay, not by whom (subject) who earns that income.

4. CONCLUSION AND SUGGESTION

4.1 Conclusion

The regulation of the imposition of Income Tax on income from the construction services business, namely GR 51 of 2008 jo GR 40 of 2009 does not reflect justice with the following reasons:

- a. Income tax is imposed from gross income so that it deviates from the principle of Vertical Equity (justice) which requires that the basis for imposing a fair income tax be from net income because it is the right measure in reflecting the ability to pay taxes (ability to pay principle).
- b. The imposition of final income tax based on the provisions of Article 4 paragraph (2) of the 2008 Income Tax Law by a specific rate that different from the general rate under Article 17 paragraph (1) of the 2008 Income Tax Law is a discriminatory provision and deviates from Horizontal Equity because it discriminates tax imposition based on type or source of income.

4.2 Suggestion

The government needs to amend GR 51 of 2008 jo GR 40 of 2009 by reconstructing the provisions as follows:

- a. For taxpayers as construction services companies that according to the provisions obligated to hold bookkeeping and individual construction service entrepreneurs who are not obliged but able to provide bookkeeping are subject to the general rate of Article 17 (1) of Income Tax Law and not final so that not be imposed by the Final Income Tax.
- b. Recognizing that not all individual taxpayers can provide bookkeeping, the construction service individuals that have gross income not more than Rp.4,800,000,000 in 1 (one) tax year and unable to conduct the bookkeeping, can remain subject to final income tax on the gross income. The rate can be at the same rate as to the Final Income Tax rate applicable to Micro, Small and Medium Enterprises (MSMEs) Taxpayers.

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B. Regulations

- Law Number 7 of the Year 1983 regarding Income Tax as lastly amended by Law Number 36 of the Year 2008
- Government Regulation Number 51 of the Year 2008 regarding Income Tax on Income Earning From Construction Services as lastly amended by Law Number 40 of the Year 2009